STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

CENTRAL ILLINOIS LIGHT COMPANY	)	
	)	
Petition for an Order Concerning Delineation of Transmission and Local Distribution Facilities.	)	Docket No. 01-0465
	)	
CENTRAL ILLINOIS LIGHT COMPANY	)	
	)	
Petition for Approval of Residential Delivery Services Implementation Plan Pursuant to Section 16-105 of the Illinois Public Utilities Act.	)	Docket No. 01-0530
	)	
CENTRAL ILLINOIS LIGHT COMPANY	)	
	)	
Petition requesting the Illinois Commerce Commission to enter an order approving delivery services tariffs of Central Illinois Light Company, including revisions to the existing rates, riders, terms and conditions applicable to non-residential delivery services and new rates, riders, terms and conditions applicable to residential delivery services.	)	Docket No. 01-0637

INITIAL BRIEF ON BEHALF OF CENTRAL ILLINOIS LIGHT COMPANY

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INITIAL BRIEF ON BEHALF OF
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On October 3, 2001, Central Illinois Light Company (CILCO) filed a verified petition (the "filing" or the "DST filing") requesting approval by the Illinois Commerce Commission (Commission) of new and revised delivery service rates and riders and related terms and conditions. The filing was made pursuant to Sections 16-104 and 16-108 of the Public Utilities Act (Act), which mandate that each electric utility in Illinois shall offer delivery services to all residential customers on or prior to May 1, 2002, and that at least 210 days prior to May 1, 2002, each electric utility shall file delivery service tariffs that provide for residential delivery service. The filing

represented the final phase of electric retail open access pursuant to the Illinois Electric Service Customer Choice and Rate Relief Law of 1997 (Customer Choice Law).

On June 22, 2001, as a preliminary to the October 3 DST filing, CILCO filed a petition requesting Commission approval of CILCO's proposed delineation of transmission facilities subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC) and distribution facilities under Commission jurisdiction. The proposed delineation included the assignment of electric general and common plant among the generation, transmission and distribution functions in exactly the same manner set forth in CILCO's later DST filing. The petition was assigned Docket No. 01-0465, and the proceeding was marked "Heard and Taken" on July 25, 2001. A Draft Order, supported by both Staff and CILCO, was filed with the Commission on August 16, 2001. The Commission deferred action on the Draft Order, and on its own motion directed that Docket No. 01-0465 be consolidated with CILCO's petition for approval of new delivery service rates in Docket No. 01-0637.

On August 3, 2001, CILCO filed a petition pursuant to Section 16-105 of the Act, seeking Commission approval of CILCO's Residential Delivery Services Implementation Plan (Plan). The petition was assigned Docket No. 01-0530 and consolidated with Docket Nos. 01-0465 and 01-0637. A proposed order, which incorporated Staff's comments and suggestions, was submitted by CILCO on January 11, 2001 with respect to the implementation plan. No party objected to the proposed order.

CILCO submitted the testimony of three witnesses in Docket No. 01-0465, and the testimony of eleven witnesses in the DST filing. Staff submitted testimony of one witness in Docket No. 01-0465 and the testimony of ten witnesses in the DST filing. Intervenors Illinois Industrial

Energy Consumers (IIEC) offered testimony by two witnesses in the DST filing. Intervenors Citizens Utility Board (CUB), MidAmerican Energy Company and Illinois Power Company offered no testimony.

In this brief, CILCO will address the issues that have been raised by the parties, designate those which are not contested, and respond to those that are contested.

I. RATE BASE

CILCO proposed a net delivery service rate base in this proceeding in the amount of $299,236,000. Staff proposed adjustments to rate base, which incorporated the recommendations of IIEC witness Chalfant and Staff witness Sweatman to reallocate common and general plant. The total rate base adjustments proposed by Staff result in a net reduction of rate base in the amount of $39,844,000, and produce a net proposed rate base of $259,392,000. (ICC Staff Ex. 11.1, Sch. 11.3.)

A. Uncontested Rate Base Issues:

Staff's proposed rate base adjustments that are not contested by CILCO are as follows:

a. A $26,000 reduction in year-to-date additions to electric distribution plant to reduce the effect of rounding (ICC Staff Ex. 1.0, pp. 6-7);

b. A $10,803,000 reduction in blanket work orders to eliminate improvements that will not be in service until more than 12 months after October 3, 2001, to include Staff's calculation of the work order balances averaged over 43 and 45 months, and to eliminate future

projects that Staff contends are not known and measurable at this time (ICC Staff Ex. 1.0., pp. 8-11);

c. A reduction of $1,232,000 representing the cost of upgrading a 34.5 kv line for which CILCO had no confirmed time for completion (ICC Staff Ex. 1.0, p. 12);

d. An increase in rate base of $885,000 to correct an error by CILCO in stating the cost of the Genesis Project (ICC Staff Ex. 1.0, p. 13);

e. A reduction of $290,000 in the materials and supplies inventory to deduct accounts payable that Staff contends support the material and supplies inventory (ICC Staff Ex. 1.0, pp.3-4). CILCO does not agree with this adjustment, because CILCO believes that the adjustment, at least in part, duplicates the deduction of accounts payable in the lead/lag study used to determine cash working capital requirements. However, because of the cost (an outside consultant performed the lead/lag study) and complexity of demonstrating CILCO's position, CILCO no longer contests the adjustment;

f. A reduction of $56,000, to correct an error by CILCO in determining the cost of the Mobile Data Upgrade (ICC Staff Ex. 1.0, p. 13);

g. A reduction of $81,000 to avoid double counting of that part of the cost of the new Power Track System included in CWIP without AFUDC (ICC Staff Ex. 1.0, pp. 13-14);

h. Reductions totaling $7,999,000, representing the unfunded portion of accrued pension expenses and post-retirement benefits (ICC Staff Ex. 2.0, pp. 4-6);

i. Net increases of $23,000 in connection with the amount of customer advances and budget payment plan balances (ICC Staff Ex. 3.0, pp. 5-7).

The net reductions to rate base that are unopposed by CILCO, as set forth above, total $19,579,000, resulting in a net rate base of $279,657,000. Staff also proposed adjustments to working capital, uncollectibles, and deferred tax balances, that depend upon the final determination of the rate base and operating expenses and revenue requirements in this proceeding. CILCO will make the appropriate adjustments to these balances as part of the compliance filing. There will be adequate time for Staff to review CILCO's calculations before the rates go into effect.

B. <u>Contested Rate Base Issues</u>:

1. I-74 Improvements -

CILCO has electric distribution facilities located within the right-of-way of Interstate Highway I-74 in Peoria. The Illinois Department of Transportation (IDOT) is reconfiguring the highway, and during 2001 gave notice to CILCO to relocate its facilities not later than the dates specified in the removal notices. CILCO prepared engineering estimates of the cost of each relocation project that is to be completed before October 3, 2002, and included the costs in the 2002 construction budget. (CILCO Surrebuttal Ex. 1.5, DST, p. 9.) CILCO is moving ahead with the relocations and has already performed part of the work. (CILCO Rebuttal Ex. 1.1, DST, p. 8 and CILCO Rebuttal Exhibit 1.3, DST.) The total cost of the projects that will be completed before

October 3, 2002, is $5,742,000 (CILCO Rebuttal Ex. 1.1, DST, p. 8). This total includes $250,000 for one relocation project that IDOT does not require until 2003. However, the facilities included in that project are in sequence with the other facilities being relocated, and CILCO will perform that relocation in conjunction with the other 2002 projects to reduce overall costs. (CILCO Surrebuttal Ex. 1.5, DST, p. 10.)

Staff witness Ebrey acknowledged in her direct testimony that the relocations will take place in the future, but contended that the scope, cost and timing of the new facilities are not currently known and measurable (ICC Staff Ex. 1.0, pp. 11-12). With its rebuttal evidence, CILCO provided copies of the letters from IDOT specifying the completion dates, and provided a detailed list of each relocation project to be completed before October of 2002, the cost of each project, the name of the CILCO engineer assigned to the project, the contact person of each IDOT contractor, and a description of the work to be performed. (CILCO Rebuttal Ex. 1.4, DST, pp. 1-10.)

In response, Ms. Ebrey speculated that because IDOT's letters only "requested" completion of the projects, there was "some question" whether the projects will be completed within the 12-month time frame contemplated by Section 285.150(e). Ms. Ebrey also believed that the projects had not been approved for funding by CILCO, and recommended inclusion in rate base of only the cost of work already performed. (ICC Staff Ex. 11.0, pp. 3-4.)

In surrebuttal, CILCO witness Underwood testified that each relocation project included in the $5,742,000 total has been approved for funding and will be completed within 12 months after the DST filing. (CILCO Surrebuttal Ex. 1.5, DST, pp. 6-7.) Mr. Underwood pointed out that the completion dates specified by IDOT must be met to comply with the permits under which the existing facilities were installed in the highway right-of-way. Each permit provides:

> The State reserves the right to make such changes, additions, repairs, and relocation within its statutory limits to the facilities constructed under this permit or their appurtenances on the right-of-way as may be considered necessary to permit the relocation, reconstruction, widening, or maintaining of the highway. The applicant, upon request by the District Engineer, shall perform such alterations of change of location of the facilities without expense to the State. Should the applicant fail to make satisfactory arrangements to comply with this request within a reasonable time, the State reserves the right to make such alterations and the applicant agrees to pay for the cost incurred.

(CILCO Surrebuttal Ex. 1.5, DST, p. 8.) Thus, IDOT's "request" to relocate the facilities is actually a mandate under the permit requirements. Each letter from IDOT not only requires that the relocation be completed by a specified date, it further states that the letter serves as the 60-day notice for CILCO to begin the process of relocation. This 60-day notice initiates the "reasonable time" specified in the permit within which CILCO must make "satisfactory arrangements" to relocate its facilities.

In contending that the I-74 relocations were not known and measurable changes, Staff witness Ebrey relied upon the provisions of the Commission's rule specifying the requirements for a future change to be included in a historical test year. (Tr. 158.) Section 285.150(e) of the Commission's rules specifies that changes in rate base are known and measurable and may be included in the historical test year when the changes "are reasonably certain to occur" and "the amount of the changes are reasonably determinable." (83 Ill. Adm. Code, Part 285.) Ms. Ebrey agreed that this presents a two-pronged test: whether the change is reasonably certain to occur, and whether the cost of the change is reasonably determinable. (Tr. 157, 158-159.)

Although the IDOT letters unequivocally state that "We are requesting you to complete the process of relocating your facilities and have them completed by" the dates specified in the respective letters (CILCO Rebuttal Ex. 1.4., DST), Ms. Ebrey continued to speculate during

cross-examination that it is "possible" that the dates will change. (Tr. 187.) However, when asked what she would require beyond the specific dates of completion to convince her that CILCO must get the work done by the dates specified, Ms. Ebrey replied: "I mean if I was CILCO and I got this letter, I would probably proceed." (Tr. 188-89.) CILCO completely agrees. Having been given 60 days to begin making arrangements to relocate the facilities, and specific dates by which to complete the relocations, it would be imprudent for CILCO to delay completion of the relocation work based upon a possibility that a date may change.

To determine the cost and scope of each relocation project, CILCO prepared engineering estimates. (CILCO Surrebuttal Ex. 1.5, DST, pp. 8, 9.) Staff witness Ebrey agreed that the engineering estimates "would seem to be something reasonable to rely upon" in concluding the cost of a project is reasonably determinable. (Tr. 171.)

Thus, the Staff witness who originally recommended that the relocated facilities be excluded from rate base acknowledged that CILCO has met the two-pronged test of the Commission's rule. The Staff witness agreed that CILCO should "probably proceed" with the relocations prior to October 3, 2002. Moreover, CILCO has unequivocally stated that it will comply with IDOT's requirements and complete the relocations by that date. (CILCO Surrebuttal Ex. 1.5, DST, pp. 7, 8.) Therefore, it is a "reasonable certainty" that the changes will occur within twelve months after the DST filing. Staff also agreed that it is reasonable to rely upon the engineering estimates, so the cost of the changes is "reasonably determinable." Accordingly, CILCO has satisfied the requirements of Section 285.150(e), and there can be no reasonable doubt that the funds will be expended and the relocations completed within 12 months after the DST filing. The $5,742,000 cost of the I-74 facility relocations should be included in rate base.

2. General Plant -

General plant includes assets such as vehicles and facilities that are used exclusively to serve the electric side of CILCO's business. General plant is distinguished from common plant, in that the latter serves both the gas and the electric operations. (CILCO Rebuttal Ex. 10.2, p. 7.) The Uniform System of Accounts for electric utilities, established by FERC and adopted by the Commission (83 Ill. Adm. Code, Part 415), specifies the assets to be included in general plant without distinguishing between assets used to serve the delivery function and assets used to serve the generation function. (CILCO Rebuttal Ex. 10.2, p. 5; Tr. 515-16.) The need to separately assign general plant assets between the delivery and generation functions did not arise until the delivery function was unbundled from the generation function for the first time by the Customer Choice Law. (CILCO Surrebuttal Ex. 10.5, p. 2.)

In CILCO's initial delivery service tariff proceeding, the Commission used a general labor allocator to assign general plant assets among the generation, transmission and distribution functions. However, the Commission later stated in Docket No. 99-0013 that "As a general proposition, the Commission believes that direct assignment of costs is superior to the application of general allocators if the costs are suited to direct assignment and sufficient cost data is available to make direct assignments." Consistent with this ruling, CILCO made a detailed analysis of its electric general plant for the filings in this proceeding, identified each asset that serves a particular function, and directly assigned the asset to the function it serves.

For example, vehicles comprise approximately 54% of CILCO's electric general plant. (CILCO Rebuttal Ex. 10.2, p. 3.) CILCO caused an inventory to be taken of the specific vehicles used by the generating plants (Tr. 509, 518-19), and directly assigned those vehicles to the

generation function. The remaining vehicles were directly assigned to the delivery function, that is, transmission and distribution. Those vehicles included line trucks, trenchers, backhoes, dump trucks, and similar power-operated equipment for which the generating plants have no use. (Tr. 533, 535.) Another example is the Pioneer Park facility, which houses delivery services engineers and planners, the electric meter shop, the transformer shop, and the electric storeroom, and operates as a base for the electric crews in Peoria and as a garage for their vehicles (CILCO Rebuttal Ex. 10.2, p. 6; Tr. 535-6). Pioneer Park comprises approximately 24% of electric general plant. (CILCO Rebuttal Ex. 10.2, p. 3.) No part of the Pioneer Park facility has served the generation function since late 1999 (CILCO Rebuttal Ex. 10.2, p. 6; Tr. 535-37), and CILCO directly assigned this facility to the delivery function. The general plant other than vehicles and Pioneer Park was directly assigned between the generation and delivery functions based upon location codes maintained within the Company's records, that permit the identification and direct assignment of all general plant. (CILCO Rebuttal Ex. 10.2, p. 6.)

In his prepared rebuttal testimony, IIEC witness Chalfant stated that he "strongly" supports the Commission's preference for direct assignment of costs if the costs are suited to direct assignment. (IIEC Ex. 4, p.3.) However, despite lip service to the Commission's preferred method, Mr. Chalfant allocated general and common plant and A&G expenses without regard to the functions they actually serve. He made no attempt to analyze the individual assets in the general plant account or the common plant account to determine if they serve a particular function (Tr. 59-60). He did not study or analyze the costs in the A&G account to determine if they could be attributed to a particular function (Tr. 52). Mr. Chalfant was aware that CILCO had analyzed the individual assets and expenses in the accounts and directly assigned those that were identified exclusively with a particular function. (Tr. 58.) Mr. Chalfant ignored this detailed evidence and used

a general allocator "to allocate all general plant and the electric portions of common plant" (Tr. 59). Mr. Chalfant testified that even if 80% of general and common plant and A&G costs are identified as being related to a particular function, he would still apply a general allocator to "provide an incentive for the Company to properly account for them in future cases" (Tr. 54), recording each asset and expense in "some sort of account or subaccount that would identify it with a particular function which the expense or plant serves." (Tr. 61.)

Using his approach, Mr. Chalfant assigned 47%, or more than $6.5 million (CILCO Rebuttal Ex. 10.2, p. 5), of the vehicles in the general plant account to the generation function, although the generating plants have little need for vehicles, and only $547,000 of vehicles are actually used there. (CILCO Rebuttal Ex. 10.2, p. 5; Tr. 529-30, 32.) Similarly, 47%, or more than $2.8 million (CILCO Rebuttal Ex. 10.2, p. 6), of the Pioneer Park facility, which has not served the generation function in any way for more than two years, was assigned by Mr. Chalfant to the generation function. Mr. Chalfant did not even make a pretense of trying to justify his blatantly unreasonable allocations. (CILCO Surrebuttal Ex. 10.5, pp. 3-5.) His proposal is not cost-based and must be rejected.

In response to Mr. Chalfant's suggestion that CILCO should have an incentive to record general plant in functional accounts or subaccounts, CILCO witness Getz testified that the assets are recorded in accordance with the Uniform System of Accounts, and there is no distribution account for vehicles. (Tr. 515-16.) Mr. Getz had spoken to the Commission's Chief Accountant about recording vehicles in distribution accounts, and the Chief Accountant agreed that there were no such accounts available. (Tr. 516.) There is no practical, legal or regulatory basis for Mr. Chalfant's proposal to assign costs to functions they do not serve.

Mr. Chalfant's allocation of plant and expenses is contrary to the specific provision of Section 16-108(c) of the Act that specifies:

> "Charges for delivery services shall be cost based, and shall allow the electric utility to recover the costs of providing delivery services through its charges to its delivery service customers that use the facilities and services associated with such costs. Such costs shall include the costs of owning, operating and maintaining transmission and distribution facilities."

This provision uses the mandatory word "shall" three times, and requires cost-based assignment of assets and expenses. Mr. Chalfant's proposal is not cost-based and, therefore, violates the Act.

Mr. Chalfant suggested that some power-operated vehicles may actually be heavy equipment used at the generating plants. (Tr. 65.) The argument is pure speculation, without the slightest support in the evidence. CILCO inventoried every vehicle used at the power plants and directly assigned those vehicles to generation. Mr. Chalfant could not identify any "heavy equipment" used in the generating plants (Tr. 65), and CILCO witness Getz specifically identified the type of vehicles included in the power-operated vehicle account as being linemen's trucks equipped with hoists, backhoes and trenchers. (Tr. 533, 535.) Mr. Getz also testified that the equipment used to move coal at the power plants is recorded in electric production accounts that are assigned directly to the generating function, and is not part of the "vehicles" in the general plant account (Tr. 532).

Mr. Chalfant pointed to a cost summary workpaper that indicated that 6% of A&G expenses at the Pioneer Park facility was related to generation (Tr. 68). The document shows on its face that it was preliminary and not used for the assignment of costs in this case (Tr. 74). CILCO included this historic information with its filing because the information was requested by Staff in data requests in accordance with the minimum filing requirements specified in Docket No. 98-0454 for the first DST filings. (Tr. 75.) Mr. Getz explained that prior to 2000, approximately 6% of the

Pioneer Park personnel included plant engineers, fuel procurement and environmental personnel that served the generation function. However, those personnel had all moved to the generating plants by the end of 1999, so that there is no longer any generation function being served at Pioneer Park, and no part of that facility is allocable to generation. (Tr. 537-38.)

Staff witness Sweatman also recommended that the general labor allocator be adopted by the Commission for the electric general plant, common plant and A&G expenses. (ICC Staff Ex. 16.0, pp. 2, 6-7.) However, like Mr. Chalfant, Mr. Sweatman made no attempt to determine if the assets and costs in those accounts were directly assignable to a particular function. For example, Mr. Sweatman testified that most of the $13 million increase in common plant from the 1997 test year to the 2000 test year is associated with the implementation of CILCO's Customer One computer system. CILCO submitted specific testimony in Docket No. 01-0465 that the Customer One system served the delivery function exclusively. (Draft Order, p. 8.) However, Mr. Sweatman did not know and made no attempt to determine what function the system serves. (Tr. 419-421.) Mr. Sweatman was forthright in explaining that his approach was to use a general allocator for the overall numbers in the general and common plant accounts and the A&G account without dealing with the specific items in each. (Tr. 421.) His goal was to apply the general labor allocator to the accounts without regard to the specific functions any group of assets may serve, so long as generation still existed on the electric side. (Tr. 422.) Mr. Sweatman had CILCO's testimony that a detailed inventory was made of the vehicles used at the generating plants, that Pioneer Park was used only for the delivery service function, and that the software and buildings recorded in common plant were used exclusively for the delivery service function, but he did not take that information into account in any manner in making his recommendation. (Tr. 423.)

In his prepared testimony, Staff witness Sweatman agreed that to the extent direct assignments can be used, they are preferable to using a general allocator (ICC Staff Ex. 16.0, p. 7). In failing to consider in any manner the detailed evidence that identified general and common plant assets with the functions they serve, Mr. Sweatman not only abandoned his own principle that direct assignment should be used where possible, he ignored the conclusions of Staff in Docket No. 01-0465 that CILCO's allocation of general and common plant is reasonable and appropriate. As stated above, Staff supported the Draft Order in that docket. The Draft Order included the following:

> To properly classify common and general plant, CILCO examined the function performed by the particular asset. * * * Mr. Getz explained that detailed property records are maintained on buildings and vehicles in the property records. District or facility codes within the property records were used as the primary criteria to assign electric general and common plant to production, transmission, or distribution. For example, items identified with Duck Creek or Edwards power stations were directly assigned to production. Vehicles were separately identified and assigned to the area using them. Items coded as non-location general plant were allocated between transmission and distribution based on net plant after classification. Ms. Bilsland stated that common plant primarily represents district and general offices as well as corporate software systems. (Draft Order, p. 7.)
>
> The Customer One System is a customer information system that is fully integrated to support the functions performed within the distribution function. (Draft Order, p. 8.)
>
> Ms. Ebrey, testifying on behalf of Staff, indicated that Staff had reviewed CILCO's Petition for Order Concerning Delineation of Transmission and Local Distribution Facilities and supporting direct and supplemental testimony. Ms. Ebrey also stated that, based on this review, Staff did not object to CILCO's proposed classifications of FERC-jurisdictional transmission and state-jurisdictional local distribution facilities. (Draft Order, p. 9.)

In his rebuttal testimony, Mr. Sweatman acknowledged that Staff had supported CILCO's direct assignment of general and common plant in Docket No. 01-0465, but stated that "an additional review and analysis of the materials submitted in the delineation proceedings is warranted

in light of CILCO's more detailed filing related to specific DST rates and charges." (ICC Staff Ex. No. 16.0, p. 9.) However, Mr. Sweatman made no additional review or analysis of the materials submitted in the DST filing. He simply applied a general allocator, without regard to the detailed evidence showing the direct identification of the items in the general and common plant accounts and the A&G account. His recommendation produces the same unreasonable result as that of Mr. Chalfant. It knowingly and deliberately assigns huge dollar amounts of assets and expenses to functions they do not serve, eliminates any semblance of cost-based rates, and is in direct violation of the Customer Choice Law. CILCO's direct assignment of general plant based upon the functions served should be approved in this proceeding.

Mr. Sweatman also recommended that CILCO use a labor allocator rather than net plant to allocate delivery service plant and A&G expenses between transmission and distribution. (ICC Staff Ex. 16.0, p. 9.) However, the recommendation is purely cosmetic, because the result is the same using either allocator. (CILCO Rebuttal Ex. 10.2, pp. 6-7.)

3. Common Plant -

After being allocated between gas and electric based on the number of customers, CILCO's common plant was identified with the specific functions it serves, and then directly assigned to those functions, following the same principles set forth above for general plant. For example, the undisputed evidence shows that 48%, or $32.7 million, of electric common plant represents software systems used exclusively to serve customers, and is directly assignable to the delivery service function. (CILCO Rebuttal Ex. 10.2, p. 7.) There is no justification for using a general allocator that would assign a part of the software systems to generation.

The remainder of the common plant is represented by service centers and the Peoria office building and their fixtures and equipment, that also serve the delivery service function, and not the generation function. (CILCO Rebuttal Ex. 10.2, p. 9.) Mr. Chalfant and Mr. Sweatman propose to assign to the generation function 47% of the common plant that is used exclusively for the delivery service function. They gave no consideration to the actual usage of the common plant or the detailed evidence provided by CILCO as to the nature of the plant groups and the functions those groups serve. Mr. Sweatman continued to ignore Staff's acceptance of CILCO's direct assignments in Docket No. 01-0465. Neither Mr. Sweatman nor Mr. Chalfant offered any evidence that the general and common plant or A&G expenses directly assigned by CILCO are not identified exclusively with the functions to which they were assigned, and CILCO's evidence on those issues is undisputed. The Commission should not ignore undisputed evidence. See *Bazydlo v. Volant*, 164 Ill.2d 207, 647 N.E.2d 273, 277 (1995), where the Illinois Supreme Court stated, "Where the testimony of a witness is neither contradicted, either by positive testimony or by circumstances, nor inherently improbable, and the witness has not been impeached, that testimony cannot be disregarded by the trier of fact." The proposals of Mr. Sweatman and Mr. Chalfant with respect to common plant are not supported by any evidence and are just as arbitrary and unreasonable as the proposal to allocate 47% of electric general plant to generation without regard to the function it serves. CILCO's direct assignment of general and common plant based upon identification of the functions served is cost-based and should be approved.

4. Peoria Office Building -

Staff witness Ebrey proposed that approximately one-third of the Peoria office building be removed from rate base, based upon her contention that a portion of the building is no

longer used and useful. CILCO does not measure occupancy or usage of the building on the basis of square footage, and Ms. Ebrey based her proposal upon the number of CILCO employees in the Peoria office building during the 2000 test year as compared with the 1997 test year. Ms. Ebrey further proposed that one-third of the operating expenses related to the building be disallowed. Ms. Ebrey's proposal must be denied, for a several reasons.

First, simply because the number of employees in the building has been reduced by one-third, it does not follow that one-third of the building is no longer used and useful. CILCO witness Underwood pointed out that accounting, billing, customer service, record-keeping and other activities that were previously conducted in the building for the delivery service function are still conducted there. (CILCO Rebuttal Exhibit 1.1, DST, p. 4.) Ms. Ebrey did not dispute this testimony. (Tr. 173-4.)

Ms. Ebrey does not contend that CILCO should move out of the building, or that CILCO could reduce operating expenses by moving to smaller quarters (Tr. 176). In fact, CILCO witness Underwood demonstrated that the continued use of the building produces the lowest available operating costs. (CILCO Rebuttal Ex. 1.1, DST, pp. 5-6 .) Therefore, CILCO is acting reasonably and prudently by remaining in the building. Nonetheless, Ms. Ebrey argued that under Section 9-211 of the Act, use of the building must be both prudent and used and useful, and this requires removal of one-third of the building from rate base. (Tr. 179.) Ms. Ebrey's interpretation of this section would result in disallowance of costs that are prudently incurred and directly benefit customers. Her interpretation is not reasonable and has been rejected by the Commission.

Section 9-211 states that "The Commission, in any determination of rates or charges, shall include in a utility's rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers." In *Central Illinois*

Public Service Company, Docket No. 91-0193, the Commission addressed the requirements in Section 9-211, and pointed out that Section 9-212 defines "'used and useful' investment as that which is necessary to meet customer demand or is economically beneficial in meeting that demand." Thus, if an investment is prudent and economically beneficial to customers, it is used and useful. There is no dispute that the continued use of the building by CILCO is prudent and economically beneficial in providing service to customers. Therefore, the entire building is used and useful.

Ms. Ebrey concedes that at least two-thirds of the Peoria office building is being used by CILCO and is used and useful. Ms. Ebrey does not contend that the building can be physically divided, but her proposal necessarily assumes that the office building can be somehow separated into pieces - one of which is used and useful and the other of which is not - for rate base purposes. The Commission rejected the identical argument in *Consumers Illinois Water Company*, Docket No. 91-0317 (May 28, 1992). In that case, the utility purchased property for a lagoon. Staff argued that the lagoon was larger than needed, and that the utility had purchased more acreage than was needed. Therefore, according to Staff, a portion of the cost of the property should be denied rate base treatment. In rejecting the argument, the Commission noted that the property would not have been sold to the utility with lesser acreage absent a condemnation proceeding. Therefore, the entire site was necessary to provide service, it provided an economic benefit to ratepayers, and the entire site belonged in rate base. Staff also argued in *Consumers Illinois* that only a portion of the former treatment plant site should be included in rate base because only a portion was still being used by the utility. The Commission rejected this argument as well, stating that "Staff's suggestion that the property is somehow divisible is not supported by the record."

The decision in *Consumers Illinois Water Company* directly applies here. CILCO's office building provides the lowest cost and most efficient means of providing necessary services

to ratepayers. CILCO could not provide this economic benefit to customers without taking the entire building. Therefore, even if Ms. Ebrey were correct that CILCO does not need all the space, the entire building is used and useful because it provides an economic benefit in meeting customer requirements. In *Consumers Illinois*, the Commission elaborated on the applicable rule:

> The Commission has consistently determined that a utility is entitled to earn a return on all property which is used and useful in providing utility service. The Commission is of the opinion that the Lagoon Site is used and useful in two respects: one, it was simply needed for the construction of the Lagoon, both because the owner refused to sell any amount less than 41 acres and because of the buffer required under the special use permit; second, it is useful because it provides an economic benefit in that the acquisition of the additional acreage reduced the total cost which ratepayers must bear.

There is yet another reason why Ms. Ebrey's contention must be rejected. Ms. Ebrey acknowledged that when depreciable plant is retired, the original cost of the plant being retired is charged against the reserve for depreciation. Accordingly, even if the facility is not fully depreciated at the time of retirement, the net effect of the retirement does not reduce rate base. (Tr. 191-193.) However, in this case, Ms. Ebrey said that she was not retiring the building or the one-third part of the building she removed from rate base. She was treating it as something different, but she did not specify what. (Tr. 193-4.) However, if one-third of the building is not presently used and useful and is being removed from rate base, it must either be retired or held for future use. Property held for future use is included in rate base. Therefore, under any available accounting treatment, the net rate base remains the same, and the result is the same as if the adjustment were never made.

II. OPERATING EXPENSES

CILCO's proposed revenue requirement in its DST filing was $112,912,000. Staff proposed adjustments that would reduce revenue requirements by $20,793,000, including the effect

of Staff's proposed rate of return on the rate base proposed by Staff. The reduction in revenue requirement also reflected operating expense reductions proposed by Staff in the amount of $9,815,000, including the reallocation of A&G expenses as proposed by IIEC witness Chalfant and Staff witness Sweatman. The operating expense reductions were partially offset by net increases in State and Federal income tax obligations. CILCO will separately list the operating expense reductions that CILCO does not contest, and individually address the proposed adjustments that are contested.

A. <u>Uncontested Operating Expense Adjustments</u>:

Staff's proposed adjustments to operating expenses that are not contested by CILCO are as follows:

a. An increase of $149,000 in the annual amortization expense to reflect the net increase in the cost of the Genesis System, the Mobile Data Upgrade, and the Power Track System (ICC Staff Ex. 1.0, pp. 13-14);

b. A $500,000 reduction to eliminate the Supplier Services Group, which Staff contends CILCO did not establish will be necessary within the next year (ICC Staff Ex.12.0, pp. 7-8). CILCO believes a separate group will be required to meet the functional separation requirements under Commission rules. However, CILCO is not contesting this adjustment at this time;

c. A $43,000 reduction, to average storm restoration costs over 15 years instead of 10 years (ICC Staff Ex. 2.0, pp. 6-7);

d. A reduction of $864,000 in incentive compensation costs (ICC Staff Ex. 2.0, pp. 8-14). CILCO is not contesting this adjustment, because the Commission has regularly disallowed the cost of incentive compensation. However, CILCO notes that essentially every major utility in Illinois has incentive compensation plans. This fact alone indicates that such plans are reasonable and appropriate methods of compensating utility personnel. Accordingly, CILCO urges the Commission to revisit this issue and adopt an approach that will allow Illinois utilities to utilize incentive plans and recover their costs (See Section V of this brief);

e. A reduction of $47,000 to reflect a reduction in the amount of uncollectible expense (ICC Staff Ex. 2.0, pp. 14-15);

f. A reduction of $44,000 in the estimated cost of medical expense (ICC Staff Ex. 2.0, p. 15);

g. A total reduction of $61,000 related to reduced interest on customer deposits (ICC Staff Ex. 13.0, p. 5) and the 13-month average of customer advances (ICC Staff Ex. 3.0, pp. 5-6);

h. Total reductions of $256,000 relating to promotional and goodwill advertising and social and service club dues (ICC Staff Ex. 13.0, pp. 6-7);

i. A reduction of $148,000 to eliminate recovery of the energy efficiency tax (ICC Staff Ex. 3.0, p. 11).

The total uncontested adjustments to revenue requirement is $1,814,000, before including the tax effect, which would reduce the net revenue reduction.

B. Contested Operating Expense Adjustments:

1. Black Start Costs -

Staff witness Larson proposed the disallowance of the $79,721 annual cost of providing Black Start service. Black Start service provides the means for restoring the system to service in the event of a total shutdown. In support of his recommendation, Mr. Larson noted CILCO's pending proposal to restructure the Company by spinning the generating plants off to a separate subsidiary. Mr. Larson contended that the draft Power Supply Agreement between CILCO and the subsidiary "requires the generation subsidiary to provide Black Start service at no additional cost to the CILCO delivery service company." (ICC Staff Ex. 8.0, p.5.) Mr. Larson did not cite any provision of the Power Supply Agreement in support of his contention.

In rebuttal testimony, CILCO witness Seelye quoted the provisions of Section 4.4 of the Power Supply Agreement that specify that CILCO shall provide a written Black Start plan and "shall provide for system restoration in accordance with the Black Start Plan." Section 4.4 further specifies that if system restoration becomes necessary, the generation subsidiary shall use commercially reasonable efforts to respond to all directions "from the entity performing the restoration." (CILCO Rebuttal Ex. 5.2, pp., 12-13.) It would be difficult to find any clearer statement that it is CILCO, not the generation subsidiary, that is required to provide Black Start service. In his rebuttal testimony, Mr. Larson did not elaborate on or explain the basis of his direct testimony, he did not cite any provision of the Power Supply Agreement, and he made no effort to refute the

rebuttal testimony of Mr. Seelye. Mr. Larson's only response was that he is not convinced. Whether Mr. Larson is personally convinced cannot be considered as evidence in this proceeding. The Power Supply Agreement unequivocally states that CILCO, not the generating subsidiary, must furnish Black Start service and Mr. Larson was incorrect in his initial assumption to the contrary. The cost of Black Start service must remain in CILCO's revenue requirement.

2. Peoria Office Building -

Based upon her proposal to remove approximately one-third of the Peoria office building from rate base, Staff witness Ebrey calculated not only a $41,000 reduction in depreciation on that part of the building, she also reduced the operating costs related to the building. (ICC Staff Ex. 11.0, Sch. 11.2, p. 4, Sch. 11.9.) On the assumption that CILCO had allocated 86% of all the operating costs to delivery services, Ms. Ebrey proposed disallowance of approximately one-third of 86% of the operating expenses, or $222,000.

As pointed out earlier in this brief, Ms. Ebrey's proposal to remove part of the building from rate base cannot be sustained, and it follows that the proposed reduction in depreciation and the costs of operating the building must be rejected.

It should also be noted that Ms. Ebrey did not dispute that CILCO's costs to operate the building are the lowest reasonable amount that could be incurred to provide the necessary space for CILCO's employees and the customer service office. By definition, the costs are reasonable and prudent, and Ms. Ebrey's proposal to disallow a portion of those costs must be rejected for this additional reason.

Further, in calculating her proposed adjustment to operating costs of the building, Ms. Ebrey assumed that the operating costs should decline proportionately with any reduction in the

usage of the building. This is obviously not true. For example, $57,000 of the operating costs are represented by security costs. (ICC Staff Ex. 11.0, Sch. 11.9.) The amount indicates that this is the cost of a single security officer. Whether the needed office space was only two-thirds of the building or the entire building, the cost of security service would not change. Similarly, the cost of janitorial service and utilities would not decline pro rata with reduced use of space, so that Ms. Ebrey's proposed adjustment is based on speculation and conjecture.

Finally, it should be noted that the Peoria office building is part of CILCO's common plant. Although 86% of the electric portion of the operating costs was allocated to delivery services, the operating costs were first allocated 50% to gas service before being allocated between distribution and transmission services. Ms. Ebrey failed to recognize that half the operating costs relate to gas and incorrectly reallocated all the operating expenses. Therefore, even if she were otherwise correct in her assumptions, Ms. Ebrey has doubled the adjustment that should have been made to the building's operating expenses.

3. Depreciation Expense -

On the assumption that all Staff's adjustments to eliminate distribution plant additions and the I-74 improvements would be approved, Staff witness Ebrey reduced depreciation expense by $309,000, to reflect the related decrease in depreciation. The amount of any adjustment to depreciation expense will depend upon the ultimate decision of the Commission with respect to rate base issues. Therefore, the Commission's Order in this consolidated proceeding should direct that CILCO's compliance filing adjust depreciation expense to reflect the Commission's final decision on the rate base issues. Staff will have ample time to review CILCO's calculations after the entry of the Order.

4. Pension and OPEB Expenses -

CILCO proposed to include a pro forma adjustment to its test year revenue requirement to reflect increases in 2002 pension and OPEB plan expenses that had been actuarially determined by PricewaterhouseCoopers LLP. The additional after-tax expense that should be added to the electric distribution revenue requirement is $1,235,700. (CILCO Rebuttal Ex. 102, p. 11.) The actual expenses or income of these plans is dependent upon year-end asset values. With the decline of the stock market, the market values of the plan assets have declined 18 to 21 percent from the values used in the 2001 valuation, which means CILCO will have $3.8 million of pension expense and $2.8 million more OPEB expenses. Based upon the actuarially determined expense for 2002, CILCO has budgeted actual cash contributions to make up the earnings shortfall. (CILCO Surrebuttal Ex. 10.5, pp. 6-7; CILCO Surrebuttal Ex. 10.6.)

Staff's sole reason for opposing CILCO's proposed adjustment was that the plan "expense amounts are based on actuarial **projections,** not actuarial **valuations,"** without any further demonstration that the projection does not better represent the expense CILCO will incur. (Staff Ex. 12.0, p. 5, lines 115-116, emphasis in original). However, the record establishes that this simple difference in terminology elevates form over substance. CILCO's witness explained that the calculations performed by the independent public accounting firm PricewaterhouseCoopers are exactly the same ones performed for the annual valuations, except that valuations are performed based on year-end data for the prior year. The projections used the actual assets as of September 30, 2001, which had declined significantly since December 31, 2000. (CILCO Ex. 10.5, p. 6-7.) The Staff witness had never performed a projection or valuation of plan expense, and because she was not an actuary she could not explain what factors determine plan income and expense. (Tr. 316-317,

319.) She agreed that the primary source of plan income is income from pension assets and investments, and that if income from plan assets is not sufficient to meet the Company's obligation to retirees, CILCO will have to spend money to pay pension benefits. (Tr. 317-318.) Hence, CILCO's proposed adjustment for pension and OPEB plan expenses is based upon current, actual data from an independent accounting firm upon which management relies to determine the amounts necessary to fund the plan, and should be approved.

5. Payroll Wage Increase -

CILCO's electric distribution revenue requirement includes the effect on its historic test year of an expected 3% increase in the wages of its union-represented workforce effective July 1, 2002. Historically, for each of the last eight years, CILCO has experienced a 3% increase in union wages effective July 1. This history included years when new contracts were negotiated as well as years when the contract was already in place. (CILCO Ex. 1.5, DST, p. 2; CILCO Ex. 1.2, DST.) Staff opposed CILCO's pro forma adjustment because a new union contract has not yet been negotiated, so that in Staff's view neither the timing nor the amount of a wage increase can be certain enough to be considered known and measurable. (ICC Staff Ex. 12.0, pp. 2-3.) Section 285.150(e) of the Commission's rate case filing rules states that a utility may adjust its historical test year "for all known and measurable changes" in expenses, where such changes "are reasonably certain to occur" within 12 months from the filing date of the new tariffs and "the amount of the changes are reasonably determinable." 83 Ill.Adm.Code Section 285.150(e). In this instance, the expiration of the existing union contract is certain to occur effective July 1, 2002, and historically new union contracts have been placed into effect "as of" the date of expiration of the prior contract even when a strike or final details delay the conclusion of negotiations beyond the actual expiration

date of the prior contract. (CILCO Ex. 1.5, DST, pp. 2-3.) Because there have been 3% increases in each and every year since 1994, that percentage is a reliable expectation of the increased expense the Company will incur within 12 months from the filing date of the tariffs in this proceeding. Staff suggested that CILCO would vigorously negotiate the contract to avoid any increase; however, there is no evidence the Company or the unions will negotiate any less vigorously than in prior years that resulted in 3% increases. By insisting that the expiring contract be replaced by an executed agreement before an increase should be allowed, Staff is distorting the Commission's Rule by requiring absolute certainty instead of reasonable certainty. CILCO should be permitted to recover the payroll wage increases.

6. Parent Company Payroll Distribution -

Staff witness Pearce erroneously proposed to reduce the expenses included in CILCO's electric distribution revenue requirement by $317,000 for Parent Company Payroll Distribution Expenses that she believed related to non-regulated functions. (ICC Staff Ex. 2.0, p. 17.) However, these expenses were actually recorded in non-utility expense account 417.1, which is below the line and not included in A & G Salaries Account 920 used for the Company's calculation of its electric distribution revenue requirement. (CILCO Surrebuttal Ex. 10.5, p. 7.) The document upon which the Staff witness relied for her adjustment was schedule C-8 in CILCO Ex. 10.1. This schedule was one of various financial schedules that contain information provided to Staff pursuant to data requests, and follows the format of minimum filing requirements established in Docket 98-0454 for CILCO's initial Delivery Services Tariff filing in Consolidated Dockets 99-0119 and 99-0131. (CILCO Ex. 10.0, p. 8.) Section DST.110(b) Purpose of the Minimum Information specifies:

> These standard information requirements do not bind the Illinois Commerce Commission ("Commission", "ICC", or "ILCC") to a decision based solely on data provided pursuant to this Part. The inclusion of particular information or methodologies in these filing requirements is indicative of the Commission's desire that this information be provided by the time that a utility files its tariffs and implementation plan. It shall not give rise to a presumption or predetermination that such information or methodologies are more suitable than other information or methodologies. Nothing in these filing requirements shall be construed to mean or imply that the Commission must or will base any determination on, or solely on, the information or methodologies required in these requirements. Neither the utility nor any party to a Commission proceeding is limited by the methodologies or information described in these information requirements in making any request or recommendation to the Commission; and nothing in these information requirements shall be construed to require a utility to base its delivery services tariffs or implementation plan, in whole or in part, on the methodologies or information described in these information requirements and the Schedules referenced herein. Compliance with these information requirements does not excuse a party from discovery, and parties and Commission Staff may seek additional information through discovery.

CILCO witness Getz explained that the amounts on the Schedule upon which Staff relied had been erroneously included in the distribution column, and were not actually charged to A & G expense. CILCO Surrebuttal Ex. 10.5, p. 7. In other words, Staff was proposing to reduce CILCO's revenue requirement by an amount that had not been included in the revenue requirement. The Staff witness acknowledged that she was unable to determine whether the amount had been included in the Company's revenue requirement, and could not conclude the Company's testimony was incorrect. Tr. 308-309. Thus, the record contains no evidence contradicting CILCO's testimony that Staff's adjustment had not been included in the Company's requested revenue requirement, so the adjustment is unneeded.

7. A&G Expenses and Depreciation on Common and General Plant -

Based upon the recommendations of IIEC witness Chalfant and Staff witness Sweatman, Staff proposed to reduce the A&G operating and maintenance expenses allocated to delivery services by approximately 47%, or $4,407,000, and depreciation attributable to electric general and common plant by the same percentage, or $1,521,000. (ICC Staff Ex. 11.0, Sch. 11.2, page 4.) CILCO previously demonstrated in this brief that Staff's proposed reallocations of electric general and common plant cannot be sustained, because they deliberately ignore the functions with which the specific assets are identified, and fail to reflect the actual costs of providing delivery service to customers. Therefore, the proposed adjustment to eliminate the related depreciation in the amount of more than $1.5 million must also be rejected.

CILCO witnesses Getz and Bilsland explained in great detail that with certain specified exceptions, the overhead activities to support the generation function are now conducted in their entirety at the generating plants, and the related costs are recorded directly in the plant accounts. The exceptions are the pension and post-retirement benefits, which have not yet been separated between the generating and delivery services functions, and the cost of the Company president, who is the only executive at CILCO that has any supervisory responsibility over the generating plants. All the other A&G costs recorded in CILCO's accounts relate exclusively to the delivery service function. The pension and retirement expenses and the executive salary and related overhead that relate to both generation and delivery services are allocated between those functions using the same labor allocator approved in CILCO's last DST case and advocated by IIEC and Staff in this case. (The Executive salary and related expense were not allocated in the filing in the DST

case, but CILCO has agreed to adjust its revenue requirement in its compliance filing to reflect that adjustment. See CILCO Rebuttal Ex. 10.2, p. 10.)

IIEC witness Chalfant and Staff witness Sweatman ignored CILCO's detailed evidence identifying the A&G costs with the functions they serve, and followed the same agenda for A&G expenses that they followed with respect to general and common plant. Mr. Chalfant stated that he would not directly allocate any part of the A&G expenses even if he knew that 80% of those expenses were directly identifiable with particular functions, which, of course, is the case. Mr. Chalfant's only reason for refusing to accept direct, cost-based assignments was to provide an incentive in the future for CILCO to record the expenses in the functional areas they support. The statute does not permit abandonment of cost-based rates in order to provide an incentive. Moreover, CILCO has already recorded directly in plant accounts the cost of all the A&G services provided at the generating plants. This does exactly what Mr. Chalfant advocated, and there can be no justification for his proposal to allocate more A&G costs to generation.

The absurdity of the Chalfant/Sweatman reallocation of A&G expenses was demonstrated in the surrebuttal testimony of CILCO witness Getz. Mr. Getz pointed out that in CILCO's last DST case, the Commission approved $11,669,000 as the reasonable amount of A&G operating expense CILCO should be allowed to recover in its DST rates. In this proceeding, prior to the increase in the pension and retirement expense resulting from continuing decline in the market value of the pension and retirement funds, CILCO requested operating expenses of only $11,682,000, an increase of only $13,000, or less than one-tenth of one percent, over the three years from the 1997 to the 2000 test year. However, after all the adjustments proposed by Staff and Mr. Chalfant, CILCO's DST rates would recover only $5,809,000 for A&G expenses, a decrease of $5,860,000 (CILCO Surrebuttal Ex. 10.5, pp. 5-6), or more than 50% since the last DST case. It is

not reasonable to expect CILCO to operate its system effectively after such enormous reductions in A&G allowances. The failure of Staff and IIEC to recognize and consider the direct identification of A&G expenses with the delivery service function ignores the statutory mandate that delivery service rates shall be cost-based. The proposed allocation to generation of A&G expenses that support only the delivery service function must be denied.

8. Real Estate Taxes -

In rebuttal testimony, CILCO witness Getz explained an error in the Company's original filing that resulted in a $63,587 understatement of its distribution revenue requirement. The understatement occurred because a portion of real estate taxes on common plant had been erroneously assigned to generation. Mr. Getz explained that all the real estate taxes on property serving the power production function had been excluded from the determination of the distribution revenue requirement by an assignment on line 14 on WPC-13. Consequently, it was an error to exclude a portion of real estate taxes on common plant and allocate it to generation again on line 13 of the schedule. (CILCO Rebuttal Ex. 10.2, p. 11.)

Staff was unable to accept CILCO's proposed correction because it appeared to mean that none of the real estate taxes associated with common plant is assigned to generation. Staff's conclusion is correct. None of the real estate taxes associated with common plant is assigned to generation, nor should these costs be assigned to generation. The real estate in the common plant accounts consists of service centers and the Peoria office building and their fixtures that exclusively serve the delivery service function and not the generation functions. See Section I.B.3 of this Brief. If the Commission agrees with CILCO's direct assignment of common plant, which does not serve the generation function, then the real estate taxes on this property likewise should not be allocated

to generation. The assignment of real estate taxes on common plant should parallel the assignment of common plant between the various functions. Thus, if Staff's allocation of common plant is accepted, associated real estate taxes would also be adjusted to reflect the Staff's proposal. However, if CILCO's correction is not also accepted, the effect would be to double count the amount of real estate taxes on common plant to be excluded from the electric distribution revenue requirement, once on line 13 of WPC-13 and again on line 14, where only one adjustment would be appropriate if Staff's allocation of common plant were accepted. However, as more fully explained earlier in this Brief, Staff's allocation of common plant is clearly unsupportable, and hence the $63,587 correction, supported by CILCO's rebuttal testimony to reflect that common plant and associated real estate taxes are not properly assigned to generation, should be approved.

III. POLICY AND MISCELLANEOUS ISSUES

1. Electronic Signatures -

Staff witness Schlaf acknowledged that the issues and methods related to electronic signatures are complicated if not outright baffling. (Tr. 86.) So much so that Dr. Schlaf has proposed a series of workshops to explore those issues and methods. Those workshops are just getting under way, and there is no indication when they will be concluded. Nevertheless, Dr. Schlaf urges that the Commission's Order in this case require CILCO to accept electronic signatures on contracts and letters of agency between delivery service customers and retail electric suppliers, whether or not the workshops are completed before the Order is entered, and regardless of the conclusions reached by those workshops. (Tr. 100-101.)

CILCO is happy to participate in the workshops, but CILCO opposes Dr. Schlaf's recommendation to mandate acceptance of electronic signatures, at least at this time. Utilities must be on guard for potential "slamming," and for that reason "wet" signatures have been required to verify customer decisions. CILCO is not yet convinced that the use of electronic signatures would meet the requirements of the Consumer Fraud and Deceptive Business Practices Act (CILCO Rebuttal Ex. 2.11, DST, p. 3), which is specifically designed to prevent slamming by requiring use of wet signatures. (ICC Staff Ex. 9.0, pp. 5-6.) Equally important, the use of electronic signatures is so new and untried in the retail electric industry that it should not be mandated without a full investigation.

The provisions of the Electronic Security Act describe one means of providing a "secure" digital signature that would surely be baffling to most people (Tr. 86-7), and may prove so complex and difficult to accomplish that, instead of making arrangements for delivery service easier, it would have exactly the opposite effect. CILCO submits that the record in this proceeding does not contain sufficient or any information to enable the Commission to determine that electronic signatures will promote open access or are feasible. The workshops are already in progress, and the Commission should await the completion of those workshops before making any determination on the issue.

2. Minimum Stay Requirement -

Staff witness Schlaf recommended that CILCO require residential and small customers who return to CILCO from delivery service be required to remain on bundled service for no longer than one year. However, as pointed out by CILCO witness Turner (CILCO Rebuttal Ex. 2.11, DST, p. 4), and acknowledged by Dr. Schlaf (ICC Staff Ex. 9.0, p. 10), under Section 16-

103(d) of the Act, electric utilities, at their option, may require residential and small commercial customers to remain on bundled service for up to 24 four months after returning from delivery service. CILCO has elected to use this option at this time.

Dr. Schlaf's suggestion that it is a "harsh penalty" to require a two-year stay is unfounded. The legislature has determined that two years is appropriate, and it cannot be assumed that the legislature intended to impose a harsh penalty on residential customers. To the contrary, the Customer Choice Law provides a carefully crafted format for deregulation, with integrated provisions and numerous trade-offs to balance the overall scheme of deregulation. For example, larger customers were authorized to seek delivery service earlier, but the Customer Choice Law provided rate reductions for residential customers during the transition period.

Dr. Schlaf states that other utilities do not require a 24-month stay upon return to bundled service. However, CILCO is aware that many utilities do impose that requirement.

3. Allocation Of Black Start Costs -

CILCO proposed to allocate the cost of Black Start service based upon energy usage. IIEC witness Brubaker proposed that the costs be allocated based upon class demand. CILCO witness Bilsland testified (CILCO Rebuttal Ex. 4.5, p. 10), that CILCO does not oppose Mr. Brubaker's proposal. The proposal has no effect on total revenue requirements, but it results in a different allocation of the $79,721 annual Black Start costs among the customer classes.

4. Metering Service Costs and Assignment of CMRO Costs -

Among the options available to delivery service customers is the right to elect an alternative meter service provider (MSP). Under this option, the MSP provides the meter and

related meter services including meter-reading services. Even though an MSP provides the meter, the Company is required to capture and maintain that information for retail balancing purposes and billing. Additionally, under the Customer Choice Law, CILCO is required to stand ready to provide all standard metering service at any time in the event the customer elects to return to CILCO or the MSP defaults. This means that CILCO must maintain its metering operations in a manner that allows it to perform its obligations under the law whether or not metering services are provided by the Company to the customer.

After the initial filing, the Staff requested that the Company follow the requirements of the Commission's Order from Docket No. 99-0013. In the Company's Errata filing, CILCO re-filed its tariff charges to reflect the requirements of Commission Order from Docket No. 99-0013. The charges reflected in the Errata filing represent a credit of all direct metering costs to the customer if they chose a MSP for their metering services. The assignment of costs reflecting the credit of all metering services including metering is shown on Ms. Bilsland's Surrebuttal Exhibit 4.7 which ties directly to the Company's FERC Form 1 costs for metering services and meter investments.

In order to reflect the assignment of costs as required in the Commission's Order in Docket No. 99-0013, the Company had their consultants, who compiled the Company's distribution cost of service study for this filing, complete an analysis of the costs. The consultants analyzed the traditional study to break out the investments for meters shown on the Company's records and related metering costs. These costs reflected the embedded cost of metering services not the marginal costs. The original study which allocated al costs related to performing distribution services, including metering, was left intact and the cost assignment was broken out to reflect the assignment of costs according to the Commission's Order (CILCO Rebuttal Ex. 4.5, p. 8). The

overhead costs assigned in the study, such as those shown in the category of "CMRO," must be recovered through the delivery service rates. All investments related to metering have been credited to the customer in the Company's proposed tariffs. Costs reflecting assigned Company costs for overhead such as administrative and general should remain in the customer charge for all delivery services customers. Staff witness Sweatman proposes to recover the cost through the meter charge. The obvious difficulty with Mr. Sweatman's proposal is that customers who choose an alternative meter supplier will not receive a meter charge from the Company, and thus will not contribute to any of these costs. The regulatory obligations to stand ready to provide standard metering services is a requirement of the Customer Choice Law. Mr. Sweatman's proposed tariffs must be rejected as his proposal reflects a subsidization of costs by other rate payers for overhead costs.

5. End User Responsibility -

CILCO's tariffs contain language specifying that the retail customer remains ultimately liable for FERC jurisdictional transmission charges, including imbalance charges, if its Retail Electric Supplier (RES) fails to pay those charges and the security provided by the RES proves inadequate. This language is consistent with the Customer Choice Law, which requires that CILCO offer delivery services only to retail customers. Neither the Public Utility Act nor Commission rules require delivery services to be offered to an entity other than the retail customer. Transmission services are delivery services, and must be provided at the rates, terms and conditions established by the Federal Energy Regulatory Commission. CILCO's Open Access Transmission Tariff (OATT) does not authorize a RES to procure transmission service for the delivery of power into Illinois to a customer who is not eligible to take delivery services. The OATT further provides that the RES is the "designated agent" of the retail customer for purposes of securing transmission

services. In CILCO's last delivery service case the Commission approved similar language that provided the retail customer would be liable for transmission charges under its OATT in the event the RES failed to pay and its security was inadequate. Commonwealth Edison and Illinois Power have proposed similar provisions in their pending residential delivery services tariff proceedings. (Tr. 616.)

CILCO's provision is not only consistent with the law, which requires transmission services be provided to retail customers, but it fairly assigns the risk of non-payment to the appropriate party. CILCO has no control over the retail customer's selection of a RES, and is limited to requesting reasonable security. Since CILCO has no choice but to do business with the RES selected by the customer, it is only fair that the customer bear responsibility for its selected RES in the event of a default by the RES and the failure of reasonable security to cover the default. The retail customer also controls the usage that results in energy imbalance charges under the OATT, and is the direct beneficiary of energy supplied by CILCO in the event the customer's usage exceeds the amount scheduled by the RES. CILCO is restricted by regulations in the amount of security it can require, and even seemingly reasonable security may prove inadequate in unforeseeable circumstances or in the event of bankruptcy such as recently befell Enron. Retail customer responsibility for transmission charges is also consistent with the notion that the transmission reserved by the RES, as designated agent for the retail customer, belongs to the customer in the event of the demise of the RES so that the customer can continue to use alternative power suppliers. Absolving the retail customer from responsibility for the selection of its defaulting RES would have adverse consequences for other customers. First, the unpaid transmission charges would become bad debt expense to be recovered in higher transmission rates paid by customers who did not align themselves with the defaulting supplier. Secondly, the inability to collect unpaid

transmission charges from the retail customer will increase the security requirements that must be provided by RESs. The cost of increased security requirements will increase the costs for the RES, whose increased costs will be passed on to the retail customer, or discourage RES entry into the electric retail market.

Staff's reasons for opposing the tariff language regarding retail customer responsibility are unpersuasive. Staff's belief that liability for transmission charges would be imposed on uninformed retail customers should be addressed by educating the customer or requiring utilities to provide information to the customer. Staff is also wrong in its claim that the complexity of transmission service should negate any implication that the RES is acting as agent for the customer. Staff's opinion is not based upon the rights and responsibilities that arise from the principal and agent relationship under common law or statute. (Tr. 615.) Ordinary people routinely engage persons with special expertise to act on their behalf in matters beyond their usual capabilities. In any event, the complexity rationale should only apply to residential and small commercial customers, and not the largest customers, who by the admission of their own expert testifying in this case, "are the most likely to be sophisticated about their energy options and the need for services and should require minimal assistance from CILCO." (IIEC Ex. 2, p. 2.)

For the reasons stated above, the Commission should approve as filed the tariff language that specifies that the retail customer is ultimately responsible for transmission service charges provided to the customers in the event the RES fails to pay and the security is inadequate to cover the unpaid amount. CILCO is not opposed to providing additional information to customers to educate them regarding responsibility for transmission charges. In the alternative, the Commission should limit the relief from financial responsibility for transmission services charges to include only residential customers. Ccommercial and industrial customers should not be excused

from responsibility. In no event should any retail customers be excused from responsibility for imbalance charges since the energy to make up imbalances is provided by CILCO directly to the retail customer, and the customer has exclusive control over: (1) the energy usage that causes the imbalance charges to be incurred, and (2) the selection of its RES.

6. Section 16-103(c) Language -

Staff witness Borden recommended the deletion of certain language in the Company's proposed tariffs regarding the Company's obligation to offer service after the service has been declared competitive. He disagreed with the proposed language because he believed it contradicted Section 16-103(c) of the Public Utilities Act. In response to Staff's concern, CILCO proposed to modify the language to more closely follow the wording in the statute. CILCO's modified language appeared to satisfy Mr. Borden, except for the replacement of the word "utility" by "company." (Tr. 623.) His concern was related to the restructuring of the utility company and what entity is required to offer tariff service. (Tr. 619.) CILCO does not believe the substitution of the word "company" for "utility" would lead to any confusion on the part of the customer. In fact, using the word "utility" is more likely to be confusing because throughout CILCO's tariffs, CILCO is referred to as the "company" rather than the "utility." The Staff witness saw no harm in informing the customers of the nature of their rights to return to tariffed service should the service be declared competitive. (Tr. 623.) The Commission should approve the language proposed in CILCO's rebuttal testimony because it provides customers with useful information in terminology that is consistent with its other tariffs and in no way distorts the meaning of the statute.

7. Allocation of Account 908 Costs -

CILCO proposed to allocate costs recorded in FERC Account 908 among the customer classes based upon the number of customers in each class and the kilowatthours (kwh) used by the respective classes. Account 908 includes the costs CILCO incurs for providing assistance to customers regarding the safe, efficient and economical use of electricity. CILCO's approach fairly recognizes that customer classes with larger usage have more complex safety, supplier choice, engineering efficiency and economical use issues associated with a wide variety of electric equipment, motors, processes and other devices. IIEC opposed CILCO's allocation methodology and preferred an approach that would shift these costs to smaller users. IIEC proposed to use the relative cost of the class metering equipment to allocate Account 908 costs. However, the slightly greater investment of larger customers in meters is in no way indicative of the level of assistance CILCO provides to larger energy users whose energy consuming devices and alternatives are vastly more complex and valuable than the relative cost of the meter would suggest. It stands to reason that a 220 volt service line connection to a home for household appliances will entail less need for advice and assistance than required for a 138kV substation needed to operate a manufacturing plant for multi-ton construction equipment with hundreds of employees. CILCO's allocation methodology is reasonable and should be approved.

8. Fees -

CILCO provided testimony regarding the nature and cost of the activities that would be performed in connection with certain administrative fees to be charged by CILCO in accordance with Sections 16-122, 16-103(d), and 16-104(f) of the Public Utilities Act, Docket 99-0013 (Meter Service Unbundling) and the Company's initial delivery services tariff proceeding in Dockets 99-0119 and 99-0131 Consolidated. CILCO Exhibits 7.1, 7.2 and 7.3. Staff did not oppose the fees

and no party presented any evidence challenging CILCO's demonstration that the fees are just and reasonable. Based on the uncontroverted evidence in the record, the following CILCO fees should be approved:

Direct Access Service Request (DASR)	$ 20
Return to bundled service -Demand <1,000	$ 20
Off-cycle switching - interval meter	$ 50
Printed copy of reasonably available historical information	$ 25
Partial Requirements	
Contract Setup for nonresidential customer	$300
Monthly Administration	
Demand $ 1 MW	$150
Demand > 500 KW and < 1MW	$ 50
Demand # 500 KW	$ 25
Non-Residential ISS	
Demand $ 1 MW	$375
Demand < 1 MW	$225
Retail Electric Supplier Registration	$ 20
Meter Service Supplier Registration	$ 20

IV. COST OF CAPITAL

A. Return on Common Equity:

Dr. Roger A. Morin testified on behalf of CILCO with respect to the rate of return CILCO should be allowed to earn on common equity and rate base in this proceeding. Dr. Morin holds an undergraduate degree in electrical engineering and a master's degree in business administration from McGill University, and a Ph.D. in finance and econometrics from the Wharton

School of Business of the University of Pennsylvania. Dr. Morin has been a Lecturer at the Wharton School of Finance, an assistant professor and associate professor at the University of Montreal School of Business, a Visiting Professor of Finance at Amos Tuck School of Business at Dartmouth College, and is currently a Professor of Finance at Georgia State University and Professor of Finance for Regulated Industry at the Center for the Study of Regulated Industry at Georgia State University. Dr. Morin is also a principal in Utility Research International, an enterprise engaged in regulatory finance and economics consulting to businesses and government. He is a frequent lecturer on regulatory issues at national and regional seminars in the United States and Canada. He has testified as an expert witness in more than 80 cases before more than forty regulatory bodies, including the Federal Energy Regulatory Commission, the Federal Communications Commission, and numerous state utility commissions, and has served as a finance and regulatory consultant for numerous corporations and other entities, including the Staff of the Illinois Commerce Commission. He has authored two widely used books on utility cost of capital and has published numerous papers and monographs on finance, risk, the determination of the cost of capital and related matters. (CILCO Ex. RAM-1.)

To determine a fair and reasonable return on CILCO's invested capital, Dr. Morin performed a discounted cash flow ("DCF") analysis on two proxy groups for CILCO-- a group of 12 generation-divested electric utilities and a group of 14 widely-traded dividend-paying natural gas distribution utilities drawn from the Value Line Gas Distribution Group. (CILCO Ex. 8.0 pp. 30-31.) Applying the DCF model to his sample of 12 generation-divested electric utilities, Dr. Morin calculated a range of 12.7% using IBES growth forecasts to 12.4 % using Value Line's earnings growth forecasts as the required return on equity, unadjusted for flotation costs. Including a conservative allowance for flotation costs and using a truncated average (high and low growth

estimates removed), the range for the cost of equity was 12.8% to 13.0%. The DCF analysis of the natural gas distribution utility sample yielded cost of equity estimates of 11.3% and 14.7%, unadjusted for flotation costs. The range for the truncated average with the allowance for flotation costs produced a range of 11.5% to14.2%.

Dr. Morin also performed six risk premium analyses, including two risk premium estimates based respectively on the capital asset pricing model (CAPM) and on an empirical approximation of the CAPM (ECAPM). The other four risk premium studies analyzed historical and allowed risk premiums over long-term Treasury bonds for the electric and natural gas distribution industries. (CILCO Ex. 8.0, pp. 14-30.) The CAPM model indicated a required return on common equity of 10.9% without flotation costs, and the empirical CAPM estimate showed a required return of 11.6% without flotation costs. The other risk premium estimates were remarkably convergent and homogeneous with an 11.0% -11.6% range attesting to their reliability. (CILCO Ex. 8.0 p. 29.)

Based on the results of all his analyses and the application of his professional judgment, Dr. Morin's opinion was that a just and reasonable return on the common equity of CILCO's electricity delivery operations is in the range of 11.0% to 13%. He recommended that the Commission use the midpoint of the range, 12.0%, for ratemaking purposes.

Staff witness Michael McNally presented rate of return testimony on behalf of the Staff. His relative inexperience (Tr. 235-236) reflected several fundamental shortcomings in his underlying analysis. His approach represents a significant departure from Staff's approach in other cases, and even his own method in another pending residential delivery services tariff proceeding. First, the group of purportedly similar risk companies used by Mr. McNally in his DCF and CAPM analyses omitted utilities that face business risks similar to CILCO, i.e., electric utilities. Secondly,

he made an ad hoc modification to a screening criterion that he recently used in the pending MidAmerican Energy delivery services tariff proceeding. Apparently, the sole purpose for abandoning the criterion that he previously considered appropriate was to include one additional company with a considerably lower return on equity that significantly depressed the average return indicated by the electric distribution sample. Finally, in constructing his sample of comparable risk companies, he disregarded the published and widely relied upon financial ratings for CILCO, and instead relied on his own contrived assessments of what he felt CILCO's ratings ought to be. As a result of these fundamental flaws in his analysis he arrived at a recommendation for CILCO's rate of return on common equity that is appreciably lower than the other similarly situated major electric distribution companies doing business in Illinois. Dr. Morin also demonstrated that Mr. McNally's allowance of 7 basis points for flotation understated the cost of equity by nearly 23 basis points (CILCO Ex. 8.1, pp. 4-12, 27), and that Mr. McNally's failure to recognize more realistic beta estimates in his raw form CAPM analysis further understated his recommended return by 60 basis points.

In this case, Mr. McNally's final rate of return recommendation is defective because it results from a simple average of his DCF and CAPM results from only his natural gas sample. In sharp contrast, in MidAmerican Energy Company's current DST proceeding (Docket 01-0444) Mr. McNally's final return on equity recommendation is expressed as a midpoint estimate derived from the DCF and CAPM results of both the electric sample and the gas sample. Had he followed the same procedure as he did in the MidAmerican case, the midpoint of the averages of the DCF and CAPM results for both the electric and gas samples would indicate a rate of return equal to 11.15% to which he would add 0.07% for flotation costs, bringing the final recommendation to 11.22%. He failed to provide a persuasive justification for switching his methodology in this docket, and it is

particularly peculiar that he would disregard the electric sample, given the need to evaluate the required return for CILCO's electric distribution operations, and the obvious similarities that ought to be present in the electric distribution activities of CILCO and MidAmerican. (CILCO Ex. 8.1, p. 25.) The Staff witness's refusal to consider the electric utility sample represents an abrupt departure from Staff's rate of return analysis in CILCO's last DST case. In that case, Staff witness Pregozin relied exclusively on "ten companies that were selected based on percentage of revenues from electric operations." 1999 Ill. PUC LEXIS 649, 96 (Ill. C. C. August 25, 1999)

To rationalize the deflated recommended rate of return produced by limiting his comparison of CILCO to natural gas utilities with higher credit ratings and lower business risk profiles, Mr. McNally had to contrive unconvincing excuses for disregarding the published and widely relied upon financial ratings for CILCO. CILCO's current Standard & Poor's (S&P) credit rating is BBB-, and S&P assigned CILCO a business risk profile of 4. These actual ratings more closely resemble the lower S&P credit rating (A or A+) and business profile (4.8) of his Electric Sample than his Natural Gas Sample (AA- / 3). Mr. McNally conjectured that CILCO would have retained the AA- credit rating established in 1994 but for the acquisition of CILCO's parent company by AES Corporation. Obviously missing from his speculation about what CILCO's rating would be absent the AES acquisition, is an explanation of why other Illinois electric distribution companies do not currently have AA- credit ratings. In other words, he can only speculate that CILCO would have retained the 7 year old AA- rating rather than have an A or A+ rating like the rest of the utilities in his Electric Sample. Mr. McNally was not aware of any other instance where Staff imputed a credit rating different from the actual credit rating of any of the major Illinois utilities (Tr. 256-263) despite the fact that all of these utilities have affiliated with unregulated holding companies since 1994. His rejection of CILCO's actual business risk profile is equally

idiosyncratic. CILCO's actual S&P business profile fits squarely within S&P's judgment that "regulated distribution systems business profile assessments tend to fall within the 1-4 range." S&P states that generators generally receive business profile assessments in the 7-10 range. (ICC Staff Ex. 5.0, p. 29, fn. 36.) Mr. McNally reduced CILCO's business profile to 3 because of the ownership of generation assets. However, he did not reduce MidAmerican's profile despite its affiliation with generation assets. (Tr. 267.) In the current Illinois Power DST proceeding, Staff did reduce Illinois Power's profile, but only to 4. (Tr. 269.) In fact, the Staff witness was unable to provide a single operating risk that would distinguish CILCO from Ameren, MidAmerican Energy, Illinois Power or Commonwealth Edison. (Tr. 275-277.) MidAmerican Energy and Ameren are both combination gas and electric utilities, owned by unregulated holding companies with affiliates that own generating assets. It is incomprehensible how the Staff witness could arrive at such different rate of return recommendations for MidAmerican (11.36%), Ameren (11.39%) and CILCO (11.02%). Tr. 270, 274.

A further indication of the questionable dependability of Mr. McNally's methodology is his forsaking of a standard he utilized to construct comparable company samples in the MidAmerican docket. In that docket, he required that the comparable companies derive at least 80% of their revenues from natural gas or electric services. In this case, he inexplicably lowered the criterion to 70%, which had the effect of adding one additional company, Consolidated Edison, to his electric sample. Consolidated Edison had the lowest return in the group, and substantially lowered the average DCF cost of equity for the sample. The screening technique that he utilized in the MidAmerican case would have excluded Consolidated Edison from the electric sample selected for CILCO, and the average rate of return for the electric group would have been substantially greater. Following the same procedure as he used in the MidAmerican case, the midpoint of the

averages of the DCF and CAPM results for the electric sample (excluding Consolidated Edison) and gas samples would indicate a rate of return equal to 11.25% to which he would add 0.07% for flotation costs, bringing the final recommendation to 11.32%.

Mr. McNally's dubious approach results in a recommended rate of return on equity for CILCO's electric distribution operations that departs significantly from the returns recommended and allowed for the comparable electric distribution operations of other Illinois utilities. In the first round of DST proceedings, CILCO's allowed rate of return on equity was essentially equal to the rates of return (excluding flotation costs) approved for the electric distribution operations of Interstate Power Company, Ameren and MidAmerican Energy. See 1999 Ill. PUC LEXIS 645, 23-24 (10.45 % for Interstate); 1999 Ill. PUC LEXIS 627, 160; (10.45% for Ameren); 1999 Ill. PUC LEXIS 646, 23 (10.45% for MidAmerican); 1999 Ill. PUC LEXIS 649, 99-100 (10.45% for CILCO). Now the Staff witness is recommending a rate of return for CILCO that is significantly lower (11.02% before flotation cost adjustment) than he recommended for Ameren (11.39%) or MidAmerican (11.36%). There is no credible evidence in the record that would justify the large discrepancy in the returns on equity recommended for electric distribution operations of Ameren or MidAmerican, or for that matter, Illinois Power and Commonwealth Edison. Each of these companies that provide electric delivery services in Illinois, like CILCO, is part of a holding company with generating affiliates. The primary basis for CILCO's lower rate of return appears to be the unique and thinly justified approach of the Staff witness. Given the novelty of certain aspects of Staff's analysis, the Commission should reject Staff's midpoint and approve a rate of return on CILCO's common equity within the range developed by the Staff witness, but closer to the higher amounts currently recommended for the other Illinois utilities and Dr. Morin's final recommendation of 12%.

B. Capital Structure:

Staff witness Langfeldt recommended that the Commission include short-term debt in CILCO's capital structure. Moreover, instead of using the balance of short-term debt at the end of the test year, or the average monthly balances during the test year, Ms. Langfeldt proposed to use the average monthly balances beginning in June of 2000 and ending in June of 2001, which produces a higher average amount of short-term debt. Adding insult to injury, Ms. Langfeldt also proposed to use the cost of commercial paper in November of 2001, 2.04%, as a proxy for the test year cost. (ICC Staff Ex. 4.0, p. 11.) The cost of commercial paper at that particular time was vastly below the actual cost, 6.68%, during the test year (CILCO Rebuttal Ex. 11.7, p. 3) and far below any reasonable expectation of the cost of short-term debt over time. Ms. Langfeldt's proposal must be rejected.

CILCO witness Austin reviewed all CILCO's rate cases during the last thirty years. Although CILCO, Staff and intervenors had proposed the inclusion of short-term debt in CILCO's capital structure at various times over that period, the Commission consistently rejected the request. (CILCO Rebuttal Ex. 11.7, pp. 1-2.) Thus, Ms. Langfeldt's proposal is contrary to long-standing Commission determinations.

Mr. Austin also testified that short-term debt is not a permanent source of financing of rate base by CILCO. This was confirmed by the fact that CILCO had a zero short-term debt balance during a two-day period in September of 2001. (CILCO Surrebuttal Ex. 11.8, p. 3.) Further, under Section 6-102(c) of the Act, no utility may renew or re-fund short-term debt for any cumulative period longer than two years, without prior Commission approval. CILCO has not requested such approval, and, therefore, short-term debt cannot be a permanent source of financing

for CILCO. Staff witness Langfeldt agreed with Mr. Austin that "unless short-term debt finances rate base investments, it should not be included in the capital structure." (Tr. 585.)

Mr. Austin cited the prepared direct testimony of Staff witness Freetly in the currently pending Commonwealth Edison DST proceeding (CILCO Rebuttal Ex. 11.7, p. 2 ; Tr. 567):

> "Q. Should short-term debt be included in the capital structure of ComEd?
>
> A. No. Short-term debt is not a permanent source of financing rate base investment by ComEd."

Mr. Austin pointed out that it would not be reasonable to give disparate treatment of short-term debt in the capital structures of Illinois utilities.

In response, Staff witness Langfeldt contended that Commonwealth Edison had no short-term debt, and that this was the real reason why short-term debt was not included in Commonwealth Edison's capital structure. However, Ms. Langfeldt acknowledged that the above-quoted question and answer was the only reason cited by Staff for excluding short-term debt in the Commonwealth Edison case (Tr. 570-71). The sole reason cited for exclusion of short-term debt in the Commonwealth Edison case is consistent with the Commission's long-standing practice in CILCO's rate cases to exclude short-term debt from the capital structure.

Further, there is considerable doubt that Commonwealth Edison had no short-term debt. Commonwealth Edison's 10-Q reports for 2001, under the heading "Current Liabilities," include a line item showing "Payable to Affiliates" in the sum of $456 million as of March 31 (Tr. 572), $428 million as of June 30 (Tr. 573), and $301 as of September 30 (Tr. 574.) Similarly, the 10-Q reports for 2000 show under "Current Liabilities" a line item entitled "Notes Payable" in the sum of $277,867,000 as of September 30 (Tr. 575), $354 million as of June 30, 2000 (Tr. 585), and

$122 million as of March 31, 2000 (Tr. 584.) Thus, Commonwealth Edison undisputably had short-term debt during each of the first three quarters of 2000, and during 2001, in place of short-term notes payable, had a line item entitled "Payable to Affiliates" in amounts essentially consistent with the notes payable line items during 2000. The only reasonable conclusion is that borrowings from an affiliate after Commonwealth Edison's merger at the end of 2000 simply provided a different source of short-term debt during 2001. Under such circumstances, it is readily apparent that Staff witness Freetly meant exactly what she said when she explained in the Commonwealth Edison proceeding that short-term debt should not be included in the capital structure because "it is not a permanent source of financing."

Because it appeared that Commonwealth Edison had short-term debt during 2001 as well as 2000, Staff witness Langfeldt suggested during cross-examination that if CILCO had issued short-term notes to an affiliate instead of issuing commercial paper, she perhaps would take the position that CILCO had no short-term debt (Tr. 589). Short-term debt is, of course, short-term debt whether it is owed to an affiliate or a non-affiliate, and Ms. Langfeldt's attempt to justify Staff's position in CILCO's case essentially destroys Staff's credibility on the issue in this proceeding.

Staff witness Langfeldt also argued that Commonwealth Edison's payables to affiliates may have been accounts payable, not short-term debt. However, the record shows there is a separate line item for accounts payable and another for accrued expenses. (Tr. 595.) Ms. Langfeldt offered no reason why accounts payable to affiliates would not be recorded with other accounts payable.

Ms. Langfeldt also argued that because she was not aware of any authorization for Commonwealth Edison to borrow from an affiliate under Article 7 of the Act, the "payable to affiliates" entry on the balance sheet could not be short-term borrowing. Ms. Langfeldt's argument

cannot be sustained. Ms. Langfeldt did not know if Commonwealth Edison had received any approval from the Commission to enter into any transaction with affiliates or if approval is even required to enter into transactions other than borrowing (Tr. 598). The fact is that Section 7-101 of the Act does not distinguish between borrowing and any other contract, purchase, or exchange of goods or services with affiliates, and Commission approval is required for all such transactions. Thus, Staff's contention that it was not aware of any approval for any transactions between Commonwealth Edison and any affiliate would preclude any transaction with an affiliate.

There are exceptions to the requirements for approval under Section 7-101 of the Act. Under 83 Ill. Adm. Code, Part 310, a utility may enter into transactions with an affiliate without Commission approval if the arrangement is the most favorable to the utility as ascertained by competitive bidding. Thus, Commonwealth Edison could have entered into any contract or arrangement with an affiliate, including short-term borrowing, pursuant to the competitive bidding exception. Accordingly, Staff's suggestion that Commonwealth Edison had no authority for any borrowing or other transaction with an affiliate does not aid Staff's position.

Staff witness Langfeldt argued that because CILCO had short-term debt in place during 2000 and 2001, short-term debt is a continuing or permanent source of financing for CILCO. As noted above, this cannot be true in the absence of Commission approval under Section 6-102 of the Act. Further, if it is true for CILCO, it is also true for Commonwealth Edison that short-term debt is a permanent source of financing. It must be assumed that Staff recognized the limitations of Section 6-102 in the Commonwealth Edison proceeding and correctly concluded that short-term debt could not be a source of permanent financing for Commonwealth Edison. The same is true of CILCO. Short-term debt is not and cannot without Commission approval be a permanent source of financing. Therefore, short-term debt should not be included in CILCO's capital structure.

CILCO does not contest the other adjustments by Staff to capital structure, which reduce the amount and costs of long-term debt and preferred stock. CILCO and Staff are in agreement as to the amount of common equity. Using Staff's amounts and cost for long-term debt and preferred stock, and CILCO's recommended return on common equity, the appropriate capital structure for CILCO and the required return on rate base are as follows:

Description	Balance	Ratio	Cost	Weighted Cost
Long-term Debt	$241,362,924	38.12%	7.43%	2.83%
Preferred Stock	39,735,976	6.28%	5.43%	.34
Common Equity	352,050,391	55.60%	12.00%	6.67%
Total	$633,149,291	100.00%		9.84%

V. INCENTIVE COMPENSATION

Staff proposed to adjust CILCO's actual test year compensation paid to energy delivery management, office and technical employees by amounts paid under an incentive compensation plan. Staff Ex. 2.0. pp. 8-14. Staff did not contend that the expenses were not actually incurred during the test year, were imprudent, or that the total compensation paid to these employees was exorbitant, or more expensive than necessary to attract and retain qualified employees. Rather, Staff's argument for not allowing the expenses to be included in the revenue requirement was based primarily upon past Commission orders that disapprove recovery of the expenses of similar plans and Staff's speculation that plan might be discontinued or performance goals upon which the compensation is awarded may not be achieved in the future. In view of the fact that CILCO actually incurred these expenses, mere speculation that the expenses will not occur

in the future does not meet the test of a known and measurable change that would justify an adjustment to the historical test year level of employee compensation.

While Staff is correct that the Commission has not allowed recovery of incentive compensation plan expense in past cases, CILCO believes this past policy is out-of-step with recent trends in employee compensation programs in both regulated and competitive business environments, and continues to merit a new look by the Commission. The Commission's continued rejection of a utility's opportunity to recover a part of its managers' normal compensation sends a signal to utilities to decline to adopt incentive programs. The "better public policy [is] to recognize that ratepayers have a direct interest in the performance of utility employees. A more effective utility is beneficial to ratepayers, and incentive compensation is a good way to motivate superior performance. To reject all plan expense could be interpreted as a denial of this unobjectionable premise and a shirking of regulatory responsibility." *Mountain Fuel Supply Co*., 149 PUR4th 36, 58 (Utah PSC 1994). See also, *Bay State Gas Co.,* 139 PUR 4th 3, 48 (Mass. DPU 1992) (incentive programs provide competitive compensation levels and benefit ratepayers by enhancing the utility's ability to reduce system gas costs.)

C O N C L U S I O N

Central Illinois Light Company respectfully submits that the overwhelming weight of the evidence supports the positions taken in this brief on the contested issues. CILCO requests

the Commission to approve CILCO's DST filing as set forth above.

Respectfully Submitted,

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